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Litigation Funding in Australia

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Executive Summary

The Australian litigation funding industry is currently governed by a "light touch" regulatory regime.

That regime was established in July 2012 through regulations [1] ("**CA Regulations**") under the *Corporations Act 2001* ("**Corporations Act**"), which in effect amended that legislation. In consequence litigation funding arrangements were not generally subject to the statutory disclosure, licensing and capital maintenance requirements of the Corporations Act, provided that the litigation funder implemented adequate arrangements for the management of conflicts of interest.

Before the CA Regulations were introduced, there was no formal framework regulating litigation funding in Australia. Issues had arisen as to whether litigation funding schemes were subject to the statutory financial licensing provisions of the Corporations Act. The CA Regulations clearly established that litigation funding arrangements would not be classified as "financial products" under Chapter 7 of the Corporations Act, and introduced a form of statutory regulation for litigation funders for the first time.

Litigation funders generally remain subject to Australian law and court case management protocols (which may necessitate, among other things, disclosure of litigation funding arrangements and the posting of security for costs awards, as discussed in this Paper).

The current regulatory framework was established by the previous Government which supported class actions and litigation funders on the basis that litigation funders could "provide access to justice for a large number of consumers who may otherwise be deprived".

Based on recent statements by the new Australian Government and having regard to the recent report published by the Productivity Commission, it is very likely that the current "light touch" regulatory regime will be changed in the near future to impose more onerous requirements on litigation funders. A licensing regime for litigation funders and the introduction of capital adequacy requirements are highly likely.

[1] The *Corporations Amendment Regulation 2012 (No. 6)* was made on 12 July 2012 and come into effect on 12 January 2013.

1. Introduction

Australian litigation funders are presently subject to a "light touch" regulatory regime under the Corporations Act.

This Paper provides an overview of the "light touch" regulatory framework and discusses possible future changes to the regulatory regime.

2. Industry Overview

It has only been since 1995 that litigation funding has been lawful in Australia and the industry has grown rapidly since then as regulatory constraints have been progressively relaxed. In 1995, legislation was introduced to allow insolvency practitioners to contract to finance litigation. Further expansion occurred after the High Court ruled in 2006 that litigation funding was not an abuse of process or contrary to public policy.

In Australia, litigation funding has not faced the same competition as other jurisdictions. For example, in the United States, so called "contingency fee" arrangements encouraged private law firms to finance litigation in return for a percentage of successful litigation proceeds. In Australia and other common law jurisdictions, professional constraints based on a perceived conflict of interest prevented such arrangements, which are only possible now in a very limited form.

There are a number of litigation funders active in Australia. Bentham IMF Limited (formerly known as IMF (Australia) Limited ("**Bentham IMF**")) and Hillcrest Litigation Services Limited ("**Hillcrest Litigation**") are better known because both are listed on the Australian Securities Exchange and therefore their business affairs and activities are more transparent.

Other active litigation funders conducting business in Australia include:

- Comprehensive Legal Funding LLC (a Nevada limited liability company);
- International Litigation Funding Partners Pte Ltd (based in Singapore – previously based in Canada);
- Argentum Investum Management (a UK provider which entered the Australian market in March 2012); and
- A number of smaller private Australian financiers including Litigation Lending Services Limited, Quantum Litigation Funding Pty Ltd (which as of April 2014 appears to be under external administration) and LCM Litigation Fund Pty Ltd.

The business activities of these entities are not publicly available which prevents a meaningful assessment of their roles in the industry and the industry overall.

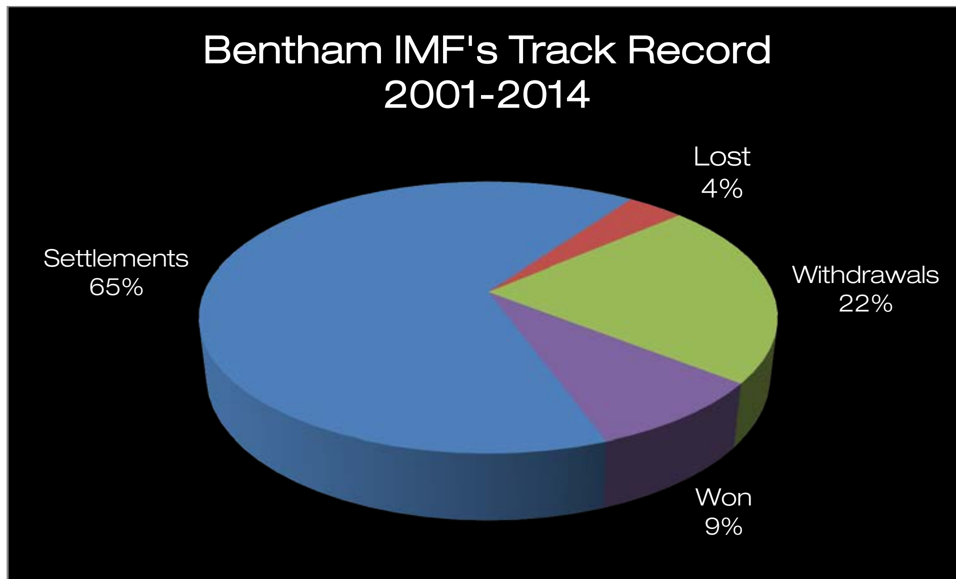
There are also other foreign litigation funders and hedge funds who are active in the market on an ad hoc basis but for the same reasons there is no transparency.

Bentham IMF was the first litigation funder to be listed on the Australian Securities Exchange in 2001. Whilst Bentham IMF operates predominately in Australia, in 2011 it opened an office in the United States and in 2014 it entered into co-funding arrangements with a US based investment advisory firm to fund cases in Asia Pacific and Europe. Bentham IMF also actively markets its services in other jurisdictions including Canada, the United Kingdom, South Africa, New Zealand and Asia.

Bentham IMF is Australia's largest and best known litigation funder with:

- an estimated market share of 85%[2] (as at 2012);
- an estimated claim value as at 30 June 2014 for its total portfolio exceeding A$2.07 billion (2013: A$1.6 billion);
- a market capitalisation of around A$326 million; and
- 30 June 2014 net assets of A$191 million (2013: A$126 million and 2012: A$112 million), EBITDA of A$15 million (2013: A$18 million) and net income of A$9.9 million (2013: A$13.8 million and 2012: A$43 million).

As at 30 June 2014, since its listing in October 2001, Bentham IMF reportedly funded 159 cases, of which it has settled 104 cases, withdrawn from 35 cases, won 14 cases and lost 6 cases.[3] Refer to chart below.



In 2013, the total income generated from the completed cases was $1.278 billion of which two thirds went to claimants and one third to IMF.[4]

Hillcrest Litigation was established in 2004 (by way of a "back door listing" through a change of activities from mining exploration to litigation funding). For the 2014 financial year, Hillcrest Litigation recorded a loss as at 30 June 2014 of A$855,157(2013: Loss of A$498,290 and 2012: Profit of A$50,688).

The Australian Federal Court class action regime was introduced in 1992, and is now an accepted feature of commercial litigation in Australia. Since then, class action proceedings in Australia have developed quickly. The long term average of new class action proceedings is 14 per year. In the 18 month period to 30 June 2014, 27 new class actions were filed in the Federal Court and Supreme Courts of Victoria and New South Wales. Of those 27 new class actions, more than 50% involved financial products and services. There is no doubt that the growth in class actions is attributable to support from the litigation funding industry which has developed at the same time. The largest successful Australian class action settlement on record was for more than A$500 million and involved a claim from the survivors of the Black Saturday bush fires (which killed 119 people,

[2] Select Equities, "Stock Update – IMF (Australia) Ltd", 23 August 2012.
[3] pp.534, Australian Government – Productivity Commission, "Access to Justice Arrangements –Draft Report", April 2014 [Accessed on 30 April 2014] <http://pc.gov.au/__data/assets/pdf_file/0008/135296/access-justice-draft.pdf>
[4] ibid.

destroyed 1200 homes and caused an estimate of $1 billion in damages) against power distributor SP Austnet and asset managers Utility Services Group. Many cases are settled out of court so it is not always possible to completely understand the landscape. For example, to date, no shareholder class action based on breaches by listed companies of the continuous disclosure obligations has proceeded to final judgment, although a number of those class actions have settled for large sums of money. Several US commentators have identified Australia as a pro-plaintiff environment emerging as perhaps the most attractive forum for class action litigation outside of the US.

The future for the litigation funding industry looks bright as the market continues to expand, especially in class actions. However, the current Australian government, Bentham IMF and others have advocated for stricter regulation and it is likely that there will be changes in the near future to the regulatory framework to impose more rigorous and onerous requirements on litigation funders which will remove the current low barrier to entry.

3. Background

3.1 Definition of Litigation Funding

Litigation funding has been judicially defined as an arrangement "where a third party in return for a stake in the outcome of proceedings shoulders the burden of litigation in terms of its management and meeting its costs, including the costs of the parties who are sued"[5].

For the purposes of this paper, litigation funding is defined as an arrangement whereby a third party (the litigation funder) pays the cost of litigation and in return, if the case is successful, receives a percentage of the proceeds of litigation.[6]

In a typical litigation funding arrangement, the funder will enter into an agreement with one or more potential litigants. The funder pays the costs of litigation and legal fees, disbursements, project management costs and claim investigation costs and usually accepts the risk of paying the other party's costs if the claim fails. In return, if the claim is successful, the funder will receive a percentage of any funds that are recovered by the litigant and the litigant will assign to the funder the benefit of any costs order they obtain. The share of proceeds agreed is typically between 25-50% of the proceeds (after reimbursement of costs).

The attraction in using litigation funding in Australia is linked to the usual costs rule in litigation which provides that an unsuccessful party is liable for at least a significant proportion of the costs of the successful party.[7] This procedural rule is implemented through an adverse costs order and is a disincentive to commencing litigation as a party will be exposed to liability for the other side's costs if unsuccessful. On this basis, litigation funding is seen as an attractive option by potential plaintiffs as the funder covers the plaintiff's own legal costs and accepts the risk of the plaintiff being liable for an adverse costs order.[8]

3.2 History of Litigation Funding

3.2.1 Maintenance & Champerty

Historically, litigation funding was a crime and/or a tort in all Australian jurisdictions which prohibited:

- Improperly encouraging litigation ("**maintenance**"); and
- Funding another's litigation for profit ("**champerty**").

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[5] Keelhall Pty Ltd v IGA Distribution Pty Ltd (2003) 54 ATR 75.
[6] Associate Professor, Faculty of Law, University of New South Wales, Sydney, Australia, "Litigation Funding in Australia" Released by the US Chamber Institute for Legal Reform, February 2012.
[7] ibid.
[8] ibid.

Today, legislation in New South Wales, Victoria, South Australia and the Australian Capital Territory has expressly abolished maintenance and champerty as a crime and as a tort. It also seems likely that maintenance and champerty are obsolete as crimes at common law.[9] However, torts of maintenance and champerty continue to exist in the Northern Territory, Queensland, Tasmania and Western Australia.

3.2.2 Insolvency Exception

A form of litigation funding received statutory approval in 1995, when insolvency practitioners were for the first time authorised by statute to contract for the funding of litigation in circumstances where the cause of action was characterised as company property.

Under section 420(2)(a) of the Corporations Act, receivers have the power to "dispose of property of the corporation" and under section 420(2)(g), receivers can "convert property of the corporation into money".[10] Under this statutory power of sale, insolvency practitioners can lawfully contract for the funding of litigation characterised as company property.[11] As a result, litigation funding companies emerged to service this market.

Liquidator's claims typically involve voidable or preference transactions or breach of trust or other malfeasance by company officers. However, the more widespread use of litigation funding arrangements was still prevented by the fact that it was difficult for funders and plaintiffs to be certain whether a particular funding arrangement might be struck down as being contrary to public policy or as an abuse of process, despite champerty and maintenance no longer being offences.

3.2.3 No Abuse of Process or Public Policy

In *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* (2006) 229 CLR 386 the High Court held that litigation funding was not an abuse of process or contrary to public policy.[12] The joint judgment of the assenting judges held that in those jurisdictions which had abolished maintenance and champerty as crimes and/or torts (i.e. Australian Capital Territory, New South Wales, South Australia and Victoria), the concept of public policy or abuse of process could not be used to found a challenge to proceedings being maintained. At present, Western Australia, Queensland, Tasmania and the Northern Territory have not yet abolished maintenance and champerty and as such, in these jurisdictions, certain contracts of maintenance or champerty still remain unenforceable. In effect the High Court agreed with the Court of Appeal and held that, in light of the repeal of the prohibitions on champerty and maintenance in several Australian jurisdictions, there could not be said to be any broadly based rule of public policy against litigation funding.

As a result of this decision, it was clear that, absent special circumstances, litigation funding arrangements would no longer be declared void as contrary to public policy, at least in New South Wales, Victoria, South Australia and the Australian Capital Territory, where the champerty and maintenance prohibitions had been abolished. The position with respect to the other jurisdictions is unclear and was not addressed by the High Court. The Law Council of Australia has previously recommended that the laws against maintenance and champerty be abolished in jurisdictions where they continue to exist.[13]

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9 Brew v Whitlock [1967] VR 449 at 450.
10 See also powers of disposal accorded to a liquidator by *Corporations Act 2001* (Cth) s 477(2)(c), and statutory powers of sale from provisions of the Bankruptcy Act 1966 (Cth), and for trustees in all jurisdictions.
11 Movitor Pty Ltd (in liq) v Sims (1996) 64 FCR 380.
12 Campbells Cash and Carry Pty Limited v Fostif Pty Ltd (2006) 229 CLR 386
13 Law Council of Australia, "Litigation Funding", 14 September 2006.

3.2.4 Financial Services Regulation

Despite the removal of the champerty and maintenance prohibitions and the clear judicial pronouncement in 2006 that litigation funding is not per se contrary to public policy or an abuse of process, until the introduction of the regulatory framework in 2012, there remained significant uncertainty regarding the extent to which litigation funding was subject to regulation under the Corporations Act's financial services regime.

Firstly, it was unclear whether class action litigation funding arrangements constituted "managed investment schemes" as defined in the Corporations Act (or "collective investments" as such schemes are sometimes called in the UK) and thus required registration under the Corporations Act. A "managed investment scheme" is defined, in essence, as a pooled investment fund in which members do not have day to day control over the operator of the fund. Registration of the "managed investment scheme" is required if it has more than 20 investors, and registration carries with it substantial compliance and disclosure obligations, including a requirement to provide a regulated document known as a "product disclosure statement" ("**PDS**") to each retail investor acquiring an interest in the scheme. In the case of a litigation funding arrangement for a large class action, registration as a managed investment scheme would require provision of a PDS to each plaintiff, among other disclosure and registration obligations. (A scheme or pooled fund with fewer than 20 investors is not, by definition, a registrable managed investment scheme under the Corporations Act, and thus this issue only arises in respect of litigation funding of class action lawsuits with large numbers of plaintiffs.)

Secondly, it was unclear whether the provision of litigation funding constituted a "financial service" under the Corporations Act and thus whether persons who undertook the business of providing litigation funding were required to obtain an Australian Financial Services Licence ("**AFSL**") in accordance with Chapter 7 of the Corporations Act.

3.2.5 No Managed Investment Scheme or Financial Product

The Full Federal Court decided in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147 ("**Brookfield Multiplex**") in October 2009 that a funded class action constituted a "managed investment scheme" which should have been registered under the Corporations Act. As a result, litigation funders would have been required to comply with requirements for collective investments known in Australia as "managed investment schemes" (which included certain disclosure and licensing requirements) under Chapters 5C and 7 of the Corporations Act.

On 15 March 2011, in *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2011] NSWCA 50 ("**Chameleon Mining**"), the New South Wales Court of Appeal unanimously held that a litigation funding agreement was a "financial product" under s 763A of the Corporations Act. This decision meant that a funded class action that was not a "managed investment scheme" could nonetheless still be deemed a "financial product" and as such would need to comply with the licensing requirements under Chapter 7 of the Corporations Act.

As a result of the decision in Chameleon Mining, the Australian Securities and Investments Commission ("**ASIC**") issued a class order (CO 10/333) which granted temporary relief to litigation funders and lawyers involved in legal proceedings structured as funded representative proceedings, from compliance with requirements under Chapters 5C and 7 of the Corporations Act.[14] This relief was extended several times, with the last extension up to 30 September 2012.[15] This relief was granted to "allow time for the Government and ASIC

[14] Australian Securities and Investments Commission, "Explanatory Statement CO 10/333.
[15] Australian Securities and Investments Commission, "ASIC grants further extension of relief – funded representative actions and funded proof of debt arrangements" 29 February 2012.

to implement the new regulatory and policy regime... without impeding affected schemes before that regime is finalised".[16]

The decision in Chameleon Mining was appealed to the High Court and on 5 October 2012 the High Court unanimously reversed the decision of the New South Wales Court of Appeal and ruled that the litigation funding agreement was not a "financial product".[17] As a result of this judgment, litigation funders were not required to comply with licensing requirements under the Corporations Act. This decision was handed down after the CA Regulations were introduced, and further affirms the Government's intentions at that time (as per the CA Regulations) to ensure that litigation funding would not be regulated under the financial services licensing regime under the Corporations Act.

4. Overview of Australian Regulation

4.1 Corporations Act

Prior to July 2012, there was no statutory framework regulating litigation funding in Australia.

On 12 July 2012, the CA Regulations, amending the Corporations Act, was introduced. The CA Regulations took effect on 12 January 2013.

In the CA Regulations Explanatory Statement, the Minister explained the rationale for the regulations as follows:

"The Federal Court's decision [in Brookfield Multiplex] would have imposed a wide range of requirements that apply to [managed investment schemes], such as registration, licensing, conduct and disclosure requirements on litigation funders and their arrangements with their clients. The Government considers that these requirements are not appropriate for litigation funding schemes....

The Regulation therefore exempts litigation funding schemes from the definition of a [managed investment scheme] in the Act. In order to clarify that these arrangements are also not financial products as defined in Chapter 7 of the Act, the Regulation also provides exemptions from the licensing, conduct and disclosure requirements in that Chapter. The Regulation also addresses potential conflicts between the interests of litigation funders and their clients in certain situations, for example when assessing proposed awards or settlements".

The Explanatory Statement stated that the Australian Government (referring to the former Australian Government) supported class actions and litigation funders as they "can provide access to justice for a large number of consumers who may otherwise have difficulties in resolving disputes", and its main objective is to "ensure that consumers do not lose this important means of obtaining access to the justice system."[18]

The new Australian Government in September 2013 brought along with it an increased likelihood of implementation of more onerous regulatory requirements on the litigation funding industry. The current Attorney General has stated that he is proposing to introduce further regulation of the litigation funding industry, however his stance appears to be focussed primarily on opposition to litigation funding companies that are owned by the principals of law firms (further discussed in Section 4.4), rather than on third party litigation funding companies.

The CA Regulations were introduced prior to the High Court handing down its judgment in *Chameleon Mining* in October 2012. That decision effectively reversed the New South Wales Court of Appeal's decision, such that litigation funding schemes would not be classified as "financial products" under Chapter 7 of the Corporations Act.

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[16] Australian Securities and Investments Commission, "Explanatory Statement CO 10/333.
[17] International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed) & Ors [2012] HCA 45.
[18] Minister for Financial Services and Superannuation, "Explanatory Statement – Select Legislative Instrument 2012 No 172 – Corporations Amendment Regulation 2010 (No. 6).

The key features of the CA Regulations are as follows:

4.1.1 No Managed Investment Scheme

Certain litigation funding schemes are exempt from the definition of “managed investment scheme” under section 9 of the Corporations Act (see Section 5C.11.01) namely those which have the following features:

(i) the dominant purpose of the scheme is for each of its members to seek remedies to which they may be legally entitled;

(ii) the possible entitlement of each of the members of the scheme to remedies arises out of:

- (A) the same, similar or related transactions or circumstances that give rise to a common issue of law or fact; or
- (B) different transactions or circumstances but the claims of the members can be appropriately dealt with together;

(iii) the possible entitlement of each of the members of the scheme to remedies relates to transactions or circumstances that occurred before or after the first funding agreement (dealing with any issue of interests in the scheme) is finalised;

(iv) the steps taken to seek remedies for each of the members of the scheme include a lawyer providing services in relation to:

- (A) making a demand for payment in relation to a claim; or
- (B) lodging a proof of debt; or
- (C) commencing or undertaking legal proceedings; or
- (D) investigating a potential or actual claim; or
- (E) negotiating a settlement of a claim; or
- (F) administering a deed of settlement or scheme of settlement relating to a claim;

(v) a person (the funder) may provide funds or indemnities under a funding agreement (including an agreement under which no fee is payable to the funder or lawyer if the scheme is not successful in seeking remedies) to enable the members of the scheme to seek remedies; and

(vi) the lawyer mentioned in subparagraph (iv) and the funder mentioned in subparagraph (v) are not members of the scheme.

4.1.2 No AFSL Required

The CA Regulations specify that any person providing a financial service in relation to a litigation funding scheme (as defined above) or any lawyer providing a financial service on a contingency fee basis (i.e. under an agreement pursuant to which payment of the lawyer’s fee is contingent on the success of the litigation) do **not** need to obtain an AFSL.

Also the CA Regulations exempt persons who are financial services licensees or authorized representatives of licensees from the requirement to comply with certain disclosure requirements in the Corporations Act (relating to maintenance of records of advice and so forth) when they offer a financial service in relation to a litigation funding scheme as defined.

4.1.3 Conflict of Interest Management

The CA Regulations specify that if a person provides a financial service covered by the exemption granted for litigation funding arrangements, then that person must maintain and follow, for the duration of the scheme, adequate arrangements for managing any conflict of interest that may arise in relation to activities undertaken by the person, or an agent of the person, in relation to the scheme.

These restrictions are intended to safeguard against circumstances in which the interests of the litigation funder (for example, in settling or compromising a claim) conflict with those of the plaintiffs.

Failure to maintain those conflict of interest arrangements is a criminal offence under the CA Regulations. Thus we expect litigation funders to implement conflict of interest arrangements even if there is some technical uncertainty as to whether they are in fact providing a "financial service" within the strict definition of the Corporations Act.

A person has "adequate arrangements" for managing a conflict of interest that may arise if the person can show through documentation that:

- The person has conducted a review of its business operations that relate to the scheme to identify and assess potential conflicts of interests;
- The person has written procedures for identifying and managing conflicts of interest and has effectively implemented those procedures;
- The written procedures are regularly reviewed;
- The written procedures include procedures about monitoring the person's operations to identify potential conflicts of interest, how to effectively disclose conflicts of interest to either members or creditors of the scheme, managing situations in which interests may conflict and protecting the interests of either members or creditors of the scheme; and
- The terms of the funding agreement are regularly reviewed to ensure the terms are consistent with the *Competition and Consumer Act 2010*.

These measures are implemented, monitored and managed by the senior management or partners of the person or entity.

In April 2013, ASIC published "ASIC Regulatory Guide 248: Litigation Schemes & Proof of Debt Schemes – Managing Conflicts of Interest" ("**ASIC RG 248**") to assist funders, exempt under the CA Regulations from the AFSL requirement, with managing conflicts.[19] This guide sets out ASIC's approach as to what ASIC considers ligation funders are required to do/provide in order to demonstrate that they have adequate arrangements for managing any conflicts of interest in compliance with the CA Regulations.[20]

The following provisions of the Corporations Act do not apply to exempt litigation funding schemes:

- Part 7.7 – which contains a range of disclosure and other requirements;
- Section 992A – which relates to the prohibition on the hawking of certain financial products (i.e. offering financial products in the course of or because of an unsolicited meeting);

[19] ASIC, "ASIC Regulatory Guide 248:Litigation Schemes & Proof of Debt Schemes – Managing Conflicts of Interest", April 2013 [Accessed on 5 May 2014] <http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg248-published-22-April-2013.pdf/$file/rg248-published-22-April-2013.pdf>
[20] Ibid.

- Part 7.9 – which contains a range of requirements relating to product disclosure, periodic reporting and other matters; and
- Part 7.10 – which contains a range of miscellaneous requirements, including a general prohibition on engaging in misleading or deceptive conduct.

The CA Regulations also exempt litigation funders from the "anti-hawking" provisions of the Corporations Act which would otherwise seriously impede the development of class action litigation. It also includes various provisions to conform the terms of the relief granted under the CA Regulations to that of other relief and legislative instruments.

4.2 Other Legislation

In addition to the CA Regulations, other legislation applies to certain litigation funders that fund class action proceedings, including the following:

- Class actions are regulated under class action provisions set out in Part IVA of the *Federal Court of Australia Act 1976* and equivalent state provisions;
- Section 33V of Part IVA of the *Federal Court of Australia Act 1976* provides that any court approval is required for a settlement or discontinuance, and any settlement must be fair, reasonable, adequate and in the interests of group members which includes fairness as between group members;
- Section 33ZF of Part IVA of the *Federal Court of Australia 1976* gives the Federal Court general supervisory power to make orders to ensure "justice is done";
- Legal Profession legislation in each state and territory regulates the conduct of solicitors in class actions and their duty as officers of the court in conducting the litigation; and
- Solicitors have a statutory obligation to pay monies that are received from the proceeds of a class action into a regulated and audited trust account, which is also protected by statutory compensation.[21]

In addition, various court procedural legislation in Australia have been amended to ensure that litigation funders are required to comply with certain procedural rules, including the following:

- Civil procedure legislation in most Australian jurisdictions imposes an obligation on litigation funders to assist the court in furthering the administration of justice. Potentially, the application of such rules could result in a litigation funder being held in contempt of court or subject to a costs order if found to be in breach of that duty. For example the *Civil Procedure Act 2010 (Vic)* extends the application of paramount duty to further the administration of justice in relation to civil proceedings beyond the parties and their lawyers to "a provider of funding or financial support, including any litigation funder". The *Civil Procedure Act 2010 (Vic)* also imposes various other overriding obligations on parties to civil proceedings including an obligation to ensure that their claims have a proper basis, not to mislead or deceive, and to use reasonable endeavours to ensure that legal costs and other costs incurred in connection with the civil proceeding are reasonable and proportionate to the complexity or importance of the issues in dispute and the amount in dispute;
- The *Civil Procedure Act 2005 (NSW)* extends the application of the "overarching purpose" (i.e. to facilitate the just, quick and cheap resolution of the real issues in proceedings) for judicial management of all civil practice and procedural matters in New South Wales to litigation funders; and
- The *Federal Court Rules 2011* and Practice Note 9 of 2010 (published by the Supreme Court of Victoria) provide for the disclosure of all litigation funding agreements. The Rules provide

[21] Law Council of Australia, "Regulation of third party litigation funding in Australia – Position Paper", June 2011.

that "at or prior to the initial case management conference each party will be expected to disclose any agreement by which a litigation funder is to pay or contribute to the costs of the proceeding, any security for costs or any adverse costs order". Victoria has a rule in nearly identical terms, and other states of Australia are considering introducing equivalent rules.

Litigation funders are also subject to general consumer protection laws including the provisions of the *Competition and Consumer Act 2010* and the *Australian Securities and Investments Commission Act 2001*. That legislation imposes restrictions on misleading or deceptive conduct, as well as unconscionable conduct. A litigation funding arrangement that is found to be unconscionable under the *Competition and Consumer Act 2010* is liable to be declared void and serious penalties can be levied for misleading or deceptive conduct.

A litigation funding business is also of course subject to general Australian law, including (among other things) tax laws, laws relating to incorporation, conduct of business, and directors' duties.

4.3 Security for Costs

In order to protect the defendant's entitlement to recover its costs from an unsuccessful plaintiff and to prevent a potential court order as to costs from being frustrated, Australian courts have a broad and unfettered discretion to order security for costs and may, in most jurisdictions, make costs orders against non-parties (such as litigation funders) when appropriate.

There is extensive commentary to the effect that where a person (i.e. the litigation funder) stands behind an impecunious or insolvent plaintiff with the primary objective of benefiting from the litigation, that person should not be able to avoid assuming the attendant risks and burdens of the litigation, including the risk of an adverse costs order if the litigation is not successful.

A court will generally consider the following factors when considering whether to make an order for security for costs against a litigation funder[22]:

- The discretion should be exercised judiciously, having regard to all relevant circumstances;
- Poverty will not prevent a person from litigating, but a corporate plaintiff may need to render security for costs;
- A defendant should bring an application for security for costs promptly;
- The strength and bona fides of the plaintiff's case are relevant considerations;
- Security for costs should only be ordered against a person who is in substance a plaintiff and not against defendants or persons forced to defend themselves;
- The mere fact that an order for security for costs will frustrate the plaintiff's right to litigate because of its financial condition does not mean the order should not be made;
- Whether there are any persons standing behind the plaintiff who are likely to benefit from the litigation and who are willing to provide the necessary security; and
- Whether persons standing behind the plaintiff have offered any personal undertakings to meet the plaintiff's liability for an adverse costs order.

The courts have a wide discretion under the rules of the court to determine the quantum of any security for costs order, and generally can make an order that security be given in "such sum as the court thinks just, having regard to all the circumstances of the case".

[22] See Legg et al., op. cit., at p. 649

4.4 Law Firms as Litigation Funders

Although the current CA Regulations relate primarily to regulation of funding by third party litigation funding entities, it is important to note the emergence in recent times of law firms acting as litigation funders.

In Australia, lawyers are prohibited from undertaking litigation on a contingency basis. For example, in New South Wales, section 325 of the *Legal Profession Act 2004 (NSW)* specifically provides that a "law practice must not enter into a costs agreement under which the amount payable to the law practice, or any part of that amount, is calculated by reference to the amount of any award or settlement or the value of any property that may be recovered in any proceedings to which the agreement relates". This prohibition does not apply to non-lawyers.

In the last two years, at least two different scenarios involving law firms in the litigation funding industry have arisen which have been controversial.

4.4.1 Maurice Blackburn

In 2012, Australian law firm Maurice Blackburn established its own litigation funding business, Claims Funding Australia Trust (with the trustee being Claims Funding Australia Pty Ltd ("**CFA**")). Two of Maurice Blackburn's principals are shareholders of CFA and a third is one of CFA's three directors. All of Maurice Blackburn's principals are beneficiaries of the discretionary trust of which CFA is trustee. An independent manager was appointed to manage the assets of the trust and provide various services including recommendations for the funding of litigation.

CFA sought approval from the Federal Court to co-fund an equine influenza class action against the Commonwealth Government which was being conducted by Maurice Blackburn. There were concerns that the funding of litigation by CFA where Maurice Blackburn was acting created a backdoor to allow Maurice Blackburn to obtain contingency fees (which would otherwise be prohibited) and gave rise to potential conflicts between Maurice Blackburn's pecuniary interest and its duty to clients.

After the application was made the Attorney General, Senator George Brandis expressed his concerns about lawyers who may, indirectly, benefit from a stake in a litigation funder who was also financing the litigation in which they were acting. Senator Brandis has stated that he is strongly opposed to litigation funding companies that are owned by the principals of law firms, funding law suits in which that law firm represents claimants and will introduce legislation to prohibit this.

As a result of this, Maurice Blackburn withdrew their application to fund the Equine influenza class action, because even if Court approval were obtained, the co-funding arrangement would be prohibited by legislation foreshadowed by the Attorney General.

4.4.2 Melbourne City Investments

Melbourne City Investments Pty Ltd ("**MCI**") was incorporated on 1 November 2012. On the day of its incorporation, MCI purchased small parcels of shares in Treasury Wine Estates Limited, Leighton Holdings Limited and Worley Parsons, as well as 17 other publicly listed companies. Since then, MCI has also purchased parcels in another 145 publicly listed companies. Each parcel of shares cost between $600 and $900. MCI issued separate class action proceedings against each of Treasury Wines, Leighton Holdings and Worley Parsons, alleging misconduct by those companies in making disclosures to the market.

MCI's sole director and shareholder, Mr Mark Elliott also acted as solicitor for MCI in all cases.

Each of Treasury and Leighton sought orders that Mr Elliott be restrained from acting as solicitor for MCI (unless Mr Elliott ceased to act for MCI or MCI was replaced as the representative plaintiff), the proceeding no longer continue as a group proceeding or the proceeding be permanently stayed, dismissed without adjudication on the merits or struck out.

In this case, the Court found that there was a real risk that Mr Elliott could not give detached, independent and impartial advice taking into account not only the interest of MCI, but also the interests of the group members. Accordingly, the Court ordered that Mr Elliott be restrained from acting for MCI whilst it was the lead plaintiff and that the proceedings not be permitted to continue as group proceedings whilst MCI and Mr Elliott acted in tandem as plaintiff and solicitor.

In the Worley Parsons case, Worley Parsons successfully challenged MCI's ability to bring the class action on the basis that it lacked standing (given that although MCI had shares in Worley Parsons, it was not a member of the group it sought to represent, and in fact MCI did not itself make any claim for compensation). The Court found that whilst MCI sought to elevate its position as lead plaintiff well above the ordinary member of the public, there was no basis for it to do so. The Court also found that the lack of claim for damages or the pleading of anything else to show that MCI had a real interest in seeking declaratory relief meant that the requirements for standing were not satisfied.

These two cases illustrate concerns arising for the interests of unrepresented group members and "lawyer driven" class action litigation.

5. Potential Changes

The CA Regulations and the hither to general trend encouraging litigation funding have been strongly opposed by some influential critics. For example, the Australian Institute of Company Directors ("**AICD**") criticised the CA Regulations on the basis that litigation funders should be subject to greater, rather than less, regulation, and some critics have called for litigation funders to be subject to prudential regulation, including capital maintenance requirements.[23]

In June 2013, the Australian Government instructed the Productivity Commission to undertake an inquiry into Australia's system of civil dispute resolution.[24] The scope of the inquiry, as set out in the Terms of Reference,[25] included consideration of alternative mechanisms to improve equity and access to justice and the extent to which these measures could contribute to cost pressure reduction. One of the measures specified was litigation funding.

On 8 April 2014, the draft report of the Productivity Commission's findings ("**Draft Productivity Commission Report**") was released. The Productivity Commission received 154 submissions for this inquiry from a range of individuals and organisations, including litigation funding companies, legal profession associations, law councils, legal commissions/legal aids/legal centres, universities and law firms. In the context of litigation funding, the Draft Productivity Commission Report recommended that:

- Third party litigation funding companies be required to hold a financial services licence, be subject to capital adequacy standards and be required to meet appropriate ethical and professional standards; and
- Treasury and ASIC work to identify the appropriate licence (either an AFSL or a separate licence category under the Corporations Act) within six months of the acceptance of this

[23] See for example http://www.mondaq.com/australia/x/188140/court+procedure/Litigation+funding+now+lightly+regulated

[24] Productivity Commission, "Access to Justice Arrangement" [Accessed on 1 May 2014] <http://www.pc.gov.au/projects/inquiry/access-justice>

[25] Productivity Commission, "Terms of Reference", [Accessed on 24 January 2014] <http://www.pc.gov.au/projects/inquiry/access-justice/terms-of-reference>

recommendation by the Commonwealth Government after consultation with relevant stakeholders.

The Draft Productivity Commission Report essentially recommended a more onerous regulatory framework for litigation funding in Australia. The final report is scheduled to be delivered to the Government in September 2014.

In addition, the current Attorney General has publicly stated (both before and after the election of the LNP Coalition Government in September 2013) that a Coalition government would review the regulation of litigation funders and examine whether they should continue to be exempt from mandatory licensing. [26] The Attorney General further indicated in May 2014 the Federal Government's plans to convene an advisory panel to examine conflicts of interest and moral hazards arising out of litigation funding, stating that he was worried that the current arrangements were "ripe for abuse".[27]

In September 2014, the US Chamber Institute for Legal Reform ("**ILR**") submitted an options paper to the Attorney General which proposed reform to the current litigation funding industry to ensure that litigation funders act in the best interests of their clients rather than their shareholders[28]. It has been reported in the media that the expert advisory panel will assess these proposals along with other recommendations on the regulation of litigation funders that were submitted to the government on 5 September 2014, and those recommendations would be in the Productivity Commission's final report. The ILR report is broadly in line with the Draft Productivity Commission Report but goes a lot further in that it would require litigation funders to give priority to the interests of their clients rather than their shareholders.[29] ILR's main concerns with the current litigation funding regime appears to be that many individuals who sign up with litigation funders are financially and legally unsophisticated and that the litigation funding industry is now "signing consumers to litigation funding and lawyers' cost agreements by way of online "click the button" websites that are focused on promoting the class action rather than informing consumer".[30]

Since the Draft Productivity Commission Report was submitted, an additional 178 submissions have been received from the public. Once the final report of the Productivity Commission is released in September this year, given the Attorney General's stance on litigation funding, it is quite likely that changes will be made to the regulatory framework so as to impose more onerous obligations on litigation funders.

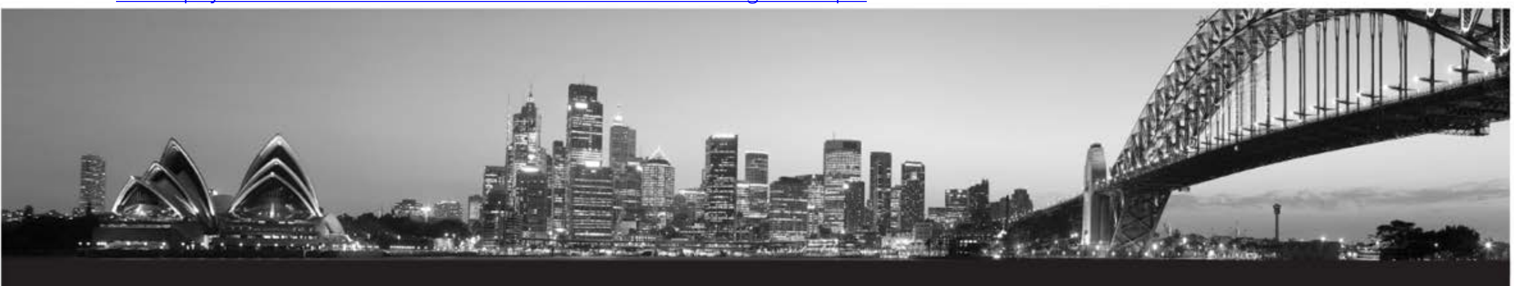
Based on matters raised in submissions to the Productivity Commission by the Law Council of Australia ("**LCA**"), AICD, Bentham IMF and ILR, as well as the Productivity Commission's Draft Report released in April 2014, we anticipate that the following issues could be addressed in any further regulation on litigation funding.

5.1 Licensing

The litigation funding industry is currently not regulated by any mandatory licensing regime which means that any person or entity can fund class action litigation in Australia (except lawyers).

The LCA considers that the current framework is inadequate, arguing that litigation funders who are effectively providing a "financial product" should be subject to appropriate regulatory requirements[31] and that a clearer regulatory framework is required given the expansion of litigation funding into areas of consumer interest.

[26] The Australian, "Brandis takes aim at litigation funders", 19 July 2013
[27] The Australian, "Crackdown on Opportunistic Class Actions" 23 May 2014.
[28] ibid.
[29] The Australian, "Call to put interests of litigation funders' clients before shareholders", 12 September 2014.
[30] ibid.
[31] Law Council of Australia, "Inquiry into Access to Justice Arrangements" [Accessed on 1 May 2014] <http://www.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/docs-2700-/2763%20-%20Inquiry%20into%20the%20Access%20to%20Justice%20Arrangements.pdf>



The Draft Productivity Commission Report has recommended that third party litigation funders be required to hold a financial services licence (whether an AFSL or a separate licence category under the Corporations Act). It also recommends that the financial conduct of litigation funders be regulated by ASIC while their ethical conduct is overseen by the Courts.

The AICD considers that the current approach provides little or no regulation of litigation funders and that litigation funders should be specifically regulated. AICD's view is that the best way to achieve this would be by the creation of a separate category of licence in Chapter 7 of the Corporations Act.[32] Alternatively, AICD recommends that litigation funders be required to obtain an AFSL including certain conditions relevant to litigation funding arrangements. However, AICD's view is that a tailored licensing regime would be more effective as it would:

- provide certainty for plaintiffs, defendants and funders;
- assist to reduce the ancillary litigation relating to the conduct of litigation funders and the nature of litigation funding agreements; and
- save the public from "obscure legislation" and regulation.

It has been reported in the media that the majority of the legal profession believe that the growing litigation funding industry should be regulated, but are divided on the requirements that should be imposed on litigation funders in order to protect group members and defendants.[33]

Before the CA Regulations were introduced, Bentham IMF was the only litigation funder in Australia that held an AFSL and it has since cancelled its AFSL given that it is not required under the existing framework.[34] As an AFSL holder, Bentham IMF was required to comply with the licensing regime under the Corporations Act which:

- imposes licensing obligations;
- provides for supervision by ASIC;
- imposes disclosure obligations;
- imposes other obligations relating to conduct connected to financial products and financial services; and
- sets out market misconduct and other prohibited conduct relating to financial products and financial services.

In essence the argument made is that an appropriate regulatory regime should be introduced to adequately protect consumers who are being encouraged to pursue class action litigation.

In Bentham IMF's submissions to the Productivity Commission in September 2013, Bentham IMF identified the need for "proportionate regulation" of litigation funders, addressing areas such as mandatory licensing under the AFSL regime, disclosure obligations and funder's duties to the Court.

5.2 Capital Adequacy – Prudential Regulation

Currently, litigation funders are not subject to any capital adequacy requirement and accordingly parties have no assurance that the litigation funder has sufficient resources to pay legal fees and meet any adverse costs order. There is some protection in the form of an order for security for costs by the court which may require that a bank guarantee or other form of security be provided to meet the costs of the defendant if the proceedings are unsuccessful. However, both AICD and

[32] Australian Institute of Company Directors, "Letter to the Access to Justice Productivity Commission – Litigation Funding & Class Actions", 4 November 2013 [Accessed on 1 May 2014]
[33] Australian Financial Review, "Litigation Funding licence needed, but debate rages over details", 5 September 2014.
[34] IMF (Australia) Ltd, "ASX Release – Australian Financial Services Licences", 19 April 2013.

the Chartered Secretaries of Australia have raised the following issues with regards to security for costs:

- A defendant may not be successful in obtaining a security for costs;
- Traditionally security for cost orders are limited to parties in the proceedings (rather than third parties);
- A security for costs order is usually made at an early stage of proceedings where the length, complexity and likely costs of the proceedings are unknown and the strength of the defendants case may not be fully appreciated; and
- If a security for costs order is made, courts normally take a more conservative approach and accordingly the amount will rarely cover all of the defendants' costs in the proceedings.[35]

In addition, it is noted with respect to cost orders that:

- Even though the funder is liable to meet all costs orders, if the funder lacks sufficient resources to meet these costs, the representative member of the class may have an exposure to costs. Given this, there is an incentive that class action promoters will commence actions regardless of whether the prospects of success are unlikely and regardless of whether the litigation funders have capital adequacy to meet those costs if the action fails; and
- Given defendants are required to incur costs as there is no guarantee that costs will be recovered even if successful, the current situation attracts unmeritorious class actions in the hope of forcing a settlement.[36]

It has been asserted that if third party funders are allowed to be involved in extensive, time consuming and costly litigation against corporations and directors for the purpose of obtaining a profit, there should be regulation to ensure that such litigation funders have sufficient assets to meet any costs orders made against them.[37]

LCA has suggested that as litigation funders' pricing practices are generally a product of assessing risks associated with litigation (similar to general insurance products), consideration should be given as to whether it would be appropriate for oversight to be undertaken by the Australian Prudential Regulation Authority.

The AICD considers that if third party funders are allowed to be involved in extensive, time-consuming and costly litigation against corporations and directors for the purpose of obtaining a profit, funders should be subject to prudential requirements to ensure that they have sufficient assets to meet any costs orders made against them.[38]

The Draft Productivity Commission Report considered the self-regulatory approach adopted by litigation funders in the United Kingdom where a "Code of Conduct for Litigation Funders" has been adopted. This Code also sets out capital adequacy requirements. The Productivity Commission in looking at this issue considered that such capital adequacy requirements were important but that it would be more appropriate for such requirements to be set out in enforceable legislation and regulated under a financial services licence rather than by an industry code.

[35] Australian Institute of Company Directors, "Letter to The Treasury – Corporations Amendment Regulation 2012", 27 January 2012.
[36] Chartered Secretaries Australia, "Letter to the Treasury – Exposure Draft: Corporations Amendment Regulations 2011 (No) Funded Class Actions", 17 August 2011.
[37] Australian Institute of Company Directors, "Letter to The Treasury – Funded Class Actions, Corporations Amendment Regulation 2011", 17 August 2011.
[38] Australian Institute of Company Directors, "Letter to the Access to Justice Productivity Commission – Litigation Funding & Class Actions", 4 November 2013 [Accessed on 1 May 2014]

5.3 Satisfying Cost Orders for Foreign Litigation Funders

At present, there appear to be at least three foreign litigation funders active in Australia.

AICD has raised concerns relating to the enforcement of cost orders made against foreign litigation funders, particularly the difficulty in enforcing orders if the foreign funder only holds assets outside of Australia. Accordingly, AICD has suggested that foreign litigation funders be required to maintain sufficient assets in Australia to meet prudential requirements and to satisfy any costs orders made against them[39]. Such costs orders and the terms of litigation funding agreements must be capable of enforcement.

6. Conclusion

The Australian government has actively considered regulation of the litigation funding industry since 2006, and at present the industry is regulated by a "light-touch" regulatory regime.

The former Australian Government (under Labor) was committed to ensuring that consumers were given "access to justice"[40] and intended to facilitate litigation funding rather than to make it more difficult or expensive. The new LNP Coalition Government has indicated that amendments to the regulatory regime are likely to impose more onerous obligations on litigation funders.

New requirements in licensing (whether through the current AFSL regime or a new licensing regime) and capital adequacy are most likely and imminent.

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Aequus Counsel Pty Ltd is a legal and corporate adviser based in Sydney Australia with significant expertise and experience in cross border transactions and the provision of advice to hedge funds and private equity.

[39] ibid.
[40] Minister for Financial Services and Superannuation, "Explanatory Statement – Select Legislative Instrument 2012 No 172 – Corporations Amendment Regulation 2010 (No. 6).

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